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To: Mr. Ted Matley
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CC: Mr. Wayne Y. Yoshioka
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RE: Comments on FEIS Related to Financial Feasibility

Dear Mr. Matley:

Recent reports by FTA[1] and correspondence between FTA and the City[2,3] clearly indicate FTA's concerns about the robustness of the last-published financial plan for the Project (i.e., *Financial Plan for Entry into Preliminary Engineering Submittal, August 2009*). The FEIS does not reflect these concerns, and the City continues to contend that the "the rail project is on solid financial footing"[4].

The Financial Feasibility section (Chapter 7.5) of the FEIS contains substantive changes from the DEIS, some of which merit comment.

<u>Use of FTA section 5307 funds to fund the Project</u>

[From Section 7.5.1 Measure of Capital Financial Feasibility, p.7.7]:

"The primary source of capital for the Project is the GET surcharge revenue. This source will fund more than 70 percent of the cost of the Project. The remainder of project funding will be from Federal transit sources, primarily from the Section 5309 New Starts program, <u>supplemented as necessary by formula Section 5307 funds</u>. While the financial plan is balanced, any capital funding shortfalls <u>including any shortfall on debt repayment incurred from the issuance of bonds, would</u>

need to be covered using additional revenues from other as-yet-unidentified sources."

Using Section 5307 funds to finance the project represents a significant departure from the DEIS. The downturn in the economy has resulted in a downward revision in projected GET surcharge revenues by about $300 million. The City now plans to offset the GET deficit (*"as necessary"*) by reallocation of $301 million of federal Section 5307 formula funds from the bus ongoing capital revenues program to the rail program. Although this reallocation may fall within the purview of Section 5307 guidelines and City Ordinance 07-001 [which states that capital cost and interest for the Project *"shall be paid entirely from general excise and use tax surcharge revenues, interest earned on the revenues, and any federal, state, or private revenues."*], at a minimum this would violate the intent and spirit of the ordinance and would certainly be contrary to what the people of Honolulu have been led to believe concerning funding of the Project. The City has assured that the bus program will not suffer from this reallocation, but it has not been forthright in disclosing that the resulting shortfall in the bus program will be made up by redirecting funds from other local revenue sources such as property and/or use taxes, or by floating additional GO bonds (which are ultimately paid off with local revenue sources). In essence, use of local funds to replace the 5307 funds that have been shifted from the bus program to the Project is equivalent to spending local-source funds on the Project directly.

Financial Feasibility by City Criteria

The City's measure of financial feasibility as stated in the DEIS and FEIS is whether GET revenues and New Starts funding are sufficient to fund the Project. In section 7.5.1 of the FEIS it is stated:

"The amount of other revenues required over and above GET surcharge and New Starts revenues provides a measure of the relative financial feasibility of the Project*. Operating costs for the transit system as a whole represent an average of 13.8 percent of the City's annual operating budget between 2019 and 2030 (Table 7-6). The Project represents approximately 25 percent of that amount ."* ***The Project is financially feasible based on this measure*** *because it would not require additional funding sources beyond the GET surcharge revenues and Federal Funds."* However, according to the Table 6.4 of the FEIS and the August 2009 Financial Plan, $301 million of FTA Section 5307 funds (i.e., *"additional funds"*) will be used fund the project. By the City's own criteria, a more accurate statement would be: ***The Project is not financially feasible based on this measure*** *because it would require additional funding through reallocation of FTA Section 5307 formula funds from bus ongoing capital expenditures to fund the Project.*

Financial Feasibility by FTA's broader criteria:

The plan to reallocate 5307 funds to the Project seems to be an expedient solution to balance the financial plan, but in so doing, funds from other public programs will have to be funneled into the bus program to maintain the existing level of bus service. This will undoubtedly affect the level and quality of these other programs. The financial feasibility of the Project needs to be judged against FTA's broader criteria of the City's capacity to provide funding resources "*without impacting other necessary City services,*" (Ref 1, p.17).

The City acknowledges that other revenue sources are hard to find: "any capital funding shortfalls ...... *would need to be covered using additional revenues from other as-yet-unidentified sources"* (FEIS 7.5.1). Although the August 2009 Financial Plan outlines several potential sources (summarized in Section 6.3.3 of FEIS), the FTA Financial Management Oversight Consultant has said that *"none of these concepts have been developed to the point that would allow their reasonableness to be established."* (Ref 1, p. 11)

In the absence of any additional funding sources that do not impact other City programs, the City's financial plan must be judged as unsound.

FTA's assessment of Financial Feasibility

While the City contends that the Financial Plan is sound, public reports and correspondence disclosed by FTA indicates that approval to continue beyond PE is tenuous unless the financial plan is bolstered.

In FTA's letter to the City granting approval to enter Preliminary Engineering (October 16, 2009)[3], FTA alerts the City (p.2) that *"Some elements of the current financial plan may not fare well in the stress tests that FTA will apply to evaluate robustness [for entry into final design]. These elements include the projected revenue stream from the General Excise Tax, the diversion of FTA Section 5307 funds from ongoing capital needs of the bus system, and the increasing share of the City's annual budget that is required to fund the transit system. Were this plan submitted today in support of a request of advance the project into final design, its weakness would likely cause FTA to deny the request"*.

In FTA's "FY 2011 New Starts Financial Assessment"[1], the Project is assigned a *Medium* rating for the overall "Project Capital Financial Plan" category. But it is extremely concerning that a *Low* rating is assigned to the sub-category "Capital Cost Estimates, Assumptions and Financial Capacity" (which comprises 50% of overall rating). This low rating reflects FTA's *"concerns about revenues, debt capacity, and the City's capacity to absorb potentially large revenue risks"*(p.2). It is further elaborated (p.11): *"The major factors* *contributing to this rating are: (i) material downside risks to the GET surcharge revenue forecast, and consequently the inability to cover all debt service cost; (ii) no net debt capacity; and (iii) lack of information to substantiate the City's capacity to absorb a material amount (up to $535 million) of cost risk. In addition to these concerns, bus capital funding – clearly needed as evidenced by the relatively old age of the bus fleet – depends on a much higher level of Federal funding than has previously been the case."*

These concerns are not reflected in the FEIS. To maintain objectivity, transparency, and credibility of the FEIS, they should be discussed in detail.

Competition with other projects for capital funding

With respect to the City's overall capacity to sufficiently fund this project, FTA has appropriately considered other capital needs of the City. FTA should be aware of a pending Consent Decree among the City, the United States EPA, the State of Hawaii, and several environmental groups. The Consent Decree mandates that the City make major upgrades to its wastewater collection and treatment facilities at significant cost. The Consent Decree was approved by City Council on July 14, 2010, and now requires approval by the United States Department of Justice, the State of Hawaii, and the environmental groups. The City estimates that upgrades of the wastewater collection system will be $3.5 billion (in 2010 $) to be completed in 10 years, and upgrades of the wastewater treatment facilities will be $1.155 billion to be completed in two stages by 2024 and 2035, for a total of $4.655 billion (2010$). The City estimates that the upgrades will be funded by increases in sewer usage fees over the next 25 years by 3-5% annually. The total cost of the projects in inflated YOE dollars is expected to be over $5.6 billion (2% annual inflation rate), and interest expense is estimated to be $1.6 billion (3.96% interest rate). The City administration contends that its constituents can pay for both the rail transit and wastewater projects with minimal financial impact on their families.

The gravity of the financial burden can be illustrated as follows:

Between 2018 and 2025 outstanding debt to fund the project will be between $2.5 and $2.9 billion.

Between 2015 and 2019, outstanding debt to fund the rail project will be between $1.1 and 1.5 billion.

Between 2016-2020, the outstanding debt for the combined projects will be between $3.5 and 4.0 billion.

Needless to say, this $7.2 billion project will severely stress the financial resources of the City and its taxpayers.

The financial implications of the wastewater projects on the rail-transit project and on the residents of Oahu should be disclosed in the FEIS.

Also, FTA must consider this major capital program in its next financial feasibility assessment.

Note: a cash flow projection for the sewer project over the period 2010-2035 based on information released by the City has been included as an appendix to this letter.

Conclusion

It is clear that the City has had to stretch to make the financial plan for the rail-transit project balance. Without additional "*as-yet-unidentified*" financial resources and the added burden of the sewer and wastewater treatment projects, the City's debt capacity will be overextended, it's bond rating will drop, and an undue financial burden will be put on its residents.

It is also clear that the planned extensions to Kapolei, UH Manoa, and Waikiki are now unaffordable and in jeopardy.

I trust that FTA will continue to bring a high level of rational analysis and financial scrutiny to the Project as it progresses through the PE stage.

Mahalo,

Richard W. Ubersax

Richard W. Ubersax, PH.D.

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[1] Federal Transit Administrationi, FY 2011 New Starts Financial Assessment, Honolulu High Capacity Transit Corridor Project, September 2, 2009

[2] Internal FTA Memorandum, "Approval of Entry into Preliminary Engineering: High-Capacity Transit Corridor Project in Honolulu, HI"; from The New Starts Team for Honolulu to Leslie T. Rogers et al; October 7, 2009

[3] Letter from Leslie T. Rogers (FTA) to Wayne Yoshioka (City), Re: Approval of Preliminary Engineering for the Honolulu High-Capacity Transit Corridor Project, October 16, 2009

[4] City press release July 16, 2010; http://www.honolulu.gov/csd/publiccom/honnews10/mayorsetstherecordstraightonrailprojectfinancing.htm

Sewer Project Cash Flow sheet

Inflation rate= 2.00%
Bond interest rate= 3.96%
Sewer rate annual adjstmnt = 4.2776%
Savings account interest rate= 2.50%

	Project TOTAL	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021	2022	2023	2024	2025	2026	2027	2028	2029	2030	2031	2032	2033	2034	2035
COSTS																											
Sewer Project cost (2010$) [from City]	3500		300	400	400	400	400	400	400	400	400																
Waste Treatment plant cost (2010$) [from City]	1155														240	240										300	375
TOTAL PROJECTS cost (2010$)	4655		300	400	400	400	400	400	400	400	400	0	0	0	240	240	0	0	0	0	0	0	0	0	0	300	375
Inflation index (relative to 2010)		1.000	1.020	1.040	1.061	1.082	1.104	1.126	1.149	1.172	1.195	1.219	1.243	1.268	1.294	1.319	1.346	1.373	1.400	1.428	1.457	1.486	1.516	1.546	1.577	1.608	1.641
TOTAL PROJECTS cost (YOE$)	5603		306	416	424	433	442	450	459	469	478	0	0	0	310	317	0	0	0	0	0	0	0	0	0	483	615
Interest expense (YOE$)	1585			8	20	32	45	58	72	86	100	115	111	106	100	106	111	104	95	85	74	62	49	33	17	-1	-2
Total cost (YOE$)	7188		306	424	444	465	487	509	531	554	578	115	111	106	410	422	111	104	95	85	74	62	49	33	17	481	613
REVENUES																											
Sewer rate index (relative to 2011)			1.000	1.043	1.087	1.134	1.182	1.233	1.286	1.341	1.398	1.458	1.520	1.585	1.653	1.724	1.798	1.874	1.955	2.038	2.125	2.216	2.311	2.410	2.513	2.621	2.733
Sewer revenue (2010 $)			312	325	339	354	369	385	401	418	436	455	474	495	516	538	561	585	610	636	663	691	721	752	784	818	853
Sewer revenue in YOE (inflated) $	13754		312	332	346	361	376	392	409	427	445	464	484	504	526	549	572	597	622	649	676	705	735	767	800	834	870
Base sewer revenues (inflated to YOE $)	6566		205	209	213	218	222	226	231	235	240	245	250	255	260	265	270	276	281	287	293	299	305	311	317	323	330
Sewer revenue dedicated to projects (YOE$)	7188		107	123	133	143	154	166	178	191	205	219	234	250	266	283	302	321	341	362	384	407	431	456	483	511	540
Bond float [+]or bond payment [-] (YOE$)			199	301	312	322	332	342	353	363	373	-104	-123	-144	144	139	-190	-217	-245	-276	-309	-344	-382	-423	-466	-29	73
Cumulative debt (YOE$)			199	500	812	1134	1466	1808	2161	2524	2897	2793	2670	2526	2670	2809	2619	2402	2157	1881	1571	1227	845	422	-44	-73	0

Notes:

<All input parameters only in green cells
<Sewer revenue dedicated to projects = total sewer revenue for any year minus base sewer revenue for that year; base sewer rate in 2011 = $205M and increased by inflation rate each successive year.
<Positive cumulative debt pays interest at Bond interest rate. Negative cumulative debt (e.g., savings account) receives the Savings account interest rate. Interest for debt accrued in year 1 are recorded in year 2 , etc.
<Sewer rate annual adjustment is calculated by "solver" in Excel so that Cumulative debt in 2035 is zero [0].
>Assumptions: Interest rates were determined by current economic conditions; annual project expenditures were apportioned based on uniform work plan for sewers vs completion date, treatment plants delayed as long as possible vs completion date.